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SUBJECT: ERDOGAN UNVEILS NEW INCENTIVE PACKAGES

¶1. (U) Summary: Turkish Prime Minister Tayyip Erdogan unveiled a new set of incentive and employment packages on June 4. Erdogan said that because of the global downturn, employment and industry have been negatively affected, but that the impact of the crisis was limited by the strong banking sector and the GOT's fiscal discipline since 2002. Under the new incentive package, Turkey will be divided into four regions and 12 industrial sectors will be prioritized. Investments in certain regions or priority industries will receive varying degrees of incentives such as tax rate cuts, social security premium supports and subsidized loans. Small and Medium Enterprises (SMEs) will be supported through a credit guarantee fund, which was recently fortified with an additional USD 1 billion. In the employment package, the GOT aims to provide short-term solutions before implementing long-term remedies to the problem. Erdogan also noted that discussions with the IMF continue. Businessmen, economists, and analysts welcomed the packages, but questioned the wisdom of incurring a high budget burden when fiscal balances are deteriorating sharply. End Summary.

¶2. (U) Turkish PM Recep Tayyip Erdogan announced the long-awaited incentive and employment packages on June 4. Erdogan said that the impact of the global crisis had been mitigated by Turkey's sound banking sector and the GOT's fiscal discipline since 2002. He described the packages as collaborative efforts between the GOT and business NGOs such as TOBB (Turkish Union of Chambers and Commodity Exchanges) and TUSIAD (Turkish Industrialists and Businessmen Association). The packages aim at supporting investment, decreasing regional economic disparities and increasing employment. Erdogan stressed during his speech that the government has so far provided a total stimulus of about TL 54 billion (USD 36 billion), which will be used through 2009 and 2010. He also noted that the new incentive scheme will add another TL 6 billion (USD 4 billion), bringing the total stimulus introduced so far to TL 60 billion (USD 40 billion). Erdogan underlined that the exact fiscal cost of these packages may vary depending on the number of applications for assistance. According to early press reports, the total cost of the new package was estimated to be around TL 3.1 billion.

Incentive Package

¶3. (U) The incentive package will apply to new investment projects in three categories:

-- large scale investment projects (in excess of TL 250

million);

-- regional investments (Turkey is divided into four regions); and

-- sector-based investments in twelve identified priority industries (electronics, chemicals, energy, transportation, automotive manufacturing, infrastructure investments for railroads and port services, healthcare, pharmaceuticals, machinery, aviation manufacturing, and mining).

¶4. (U) The incentive scheme will divide Turkey into four regions, each of which will receive different benefits.

-- The first will cover Istanbul and its environs. In this zone, high technology sectors (motor vehicles, electronics, pharmaceuticals, machinery) will benefit from a reduction of the corporate tax rate to 10 percent and reduced social security premium contributions for two years.

-- The second region, which covers most of central Anatolia and coastal Turkey, will receive support for technology investments (machinery, non-metallic minerals, technical textile, food & drink, paper) through reduction of the corporate tax rate to 8 percent and reduced social security premium contributions for 3 years.

-- The third and fourth zones cover East & Southeast Turkey, where labor-intensive sectors (agriculture, textile, clothing, leather, plastics, tourism, health,

education) will receive a reduction of the corporate tax rate to 2-4 percent, and reduced social security premium contributions for 5-7 years.

In addition to these incentives, companies that transfer their existing operations of more than 50 employees in the textiles, clothing and leather sectors from the first two regions to Eastern or Southeastern Turkey will receive an additional tax rate cut, a social security premium payment exemption for a five-year period, and GOT logistical support. These incentives will be provided for new investments through the end of 2010.

Employment Package

¶5. (U) The employment package aims to curb the sharp rise in unemployment, which hit 16.1% in March, by creating temporary employment and training or retraining the unemployed. Among the measures, the public sector will hire 120,000 temporary workers for six months to provide public services, and the GOT will finance six-month internships for 100,000 people and vocational training of 200,000 more.

¶6. (U) Erdogan noted that the government is still studying a more comprehensive employment creation remedy package for long-term solutions. Half a million people are expected to benefit from the system at a cost of TL 1 billion by end-2010, and these costs will be financed by the Unemployment Insurance Fund.

Credit Guarantee Fund for SMEs

¶7. (U) A Credit Guarantee Fund for SMEs will insure 65 percent of the loans provided by banks to SMEs over two years; the remaining 35 percent of the risk will be borne by the banks. The Treasury will transfer TL 1 billion to the Credit Guarantee Fund and this guarantee is expected to sustain a total loan amount of TL 10 billion.

Analyst and Press Reactions

¶8. (SBU) Guldem Atabay, Chief Economist from Ekpres Invest said that the measures announces sound positive if they can be implemented. Hikmet Tanriverdi, President of the Istanbul Ready-Wear Exporters Association, said that while he thinks the new incentive package is a positive step, it is not realistic to pick up and move the textile industry to the east and southeast in the short term. Tanriverdi also noted that employment creation package lacked direct remedies for the labor-intensive textile sector, which the industry had been hoping would be included. Baturalp Candemir, Chief Economist from EFG securities, observed that the new investment incentive scheme seems well-conceived to deal with short-term problems and compatible with Turkey's medium and long-term economic vision. Candemir thinks the IMF reaction to the budgetary implications will be limited due to the Fund's long-term focus, but worries that the scheme will increase the Turkish Treasury's borrowing needs. On the unemployment package, Candemir was also concerned that some corporations may be inclined to lay off unqualified workers and replace them with government-funded interns at a cheaper cost.

¶9. (U) Public statements echoed these private sentiments, but tended to be more critical of the plan. TUSIAD President Arzuhan Yalcindag noted that without an IMF deal the government will fund this package through domestic borrowing, which will squeeze out the private sector and reduce growth. Istanbul Chamber of Industry Chairman Tanil Kucuk said that the private sector "longed for more powerful measures" and lamented the lack of financial support for industry. Diyarbakir Chamber of Commerce Chairman Galip Ensarioglu criticized the lack of incentives for the mining sector.

¶10. (SBU) Comment: The new package could help alleviate some of the real sector's pain and lead to increased demand, but the effect is likely to be muted. The main drawback is that the government has not discussed the fiscal implications of the new stimulus package. The deterioration in fiscal balances has been significant and

without IMF funds the government will have to lean heavily on domestic markets to finance the budget deficit (heading towards 6 percent of GDP this year, up from just over 1 percent in 2008). According to most analysts, the best platform to bolster the GOT's fiscal credentials would be an IMF stand-by program, a move that is especially important with the GOT's domestic debt rollover at close to 120 percent. During his remarks, Erdogan reiterated that the IMF is not a "must" for Turkey and that they will not cave into "politically-motivated demands of the IMF", while adding that talks would continue until the end of June. Unless the GOT is able to come to terms with the IMF or convince other investors to finance the budget gap, the negative effects of the fiscal deterioration and the crowding out of private sector borrowing may offset any positive gains from the new incentive structure. End comment.

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